

City Council

Rich Tran, Mayor

Marsha Grilli, Vice Mayor

Garry Barbadillo, Councilmember

Bob Nuñez, Councilmember

Anthony Phan, Councilmember



**CITY OF MILPITAS - NOTICE OF SPECIAL MEETING**

**NOTICE IS HEREBY GIVEN** that a Special Meeting of the Milpitas City Council has been scheduled for Wednesday, October 18, 2017 at 5:30 PM at Milpitas City Hall, 455 E. Calaveras Blvd., Milpitas, CA in the Council Chambers on the second floor.

**SPECIAL CITY COUNCIL MEETING**

Wednesday, October 18, 2017

**5:30 PM**

Milpitas City Hall, Council Chambers 2<sup>nd</sup> floor  
455 E. Calaveras Boulevard, Milpitas, CA

**AGENDA**

**I. CALL TO ORDER / ROLL CALL / PLEDGE**

**II. PUBLIC FORUM** *Comments limited to 3 minutes or less*

**III. REPORT**

**Receive Report from the Citizens Task Force on Water Rates and a Staff Report on the Expenditure and Revenue Projections for the Water Fund (Staff Contact: Tony Ndah, 408-586-2602, Will Fuentes, 408-586-3111)**

**IV. ADJOURNMENT**

**KNOW YOUR RIGHTS UNDER THE OPEN GOVERNMENT ORDINANCE**

Government's duty is to serve the public, reaching its decisions in full view of the public. Commissions, boards, councils and other agencies of the City exist to conduct the people's business. This ordinance assures that deliberations are conducted before the people and the City operations are open to the people's review.

Materials related to an item on this agenda submitted to the City Council after distribution of the agenda would be available for public inspection at the City Clerk's office at Milpitas City Hall 3<sup>rd</sup> floor, 455 E. Calaveras Blvd., Milpitas during normal business hours.

For more information on your rights under the Open Government Ordinance or to report a violation of the ordinance, contact the City Attorney at Milpitas City Hall, 455 E. Calaveras Blvd, Milpitas, CA  
E-mail: [cdiaz@ci.milpitas.ca.gov](mailto:cdiaz@ci.milpitas.ca.gov) / Phone 408/586-3040

*The Open Government Ordinance is codified in Milpitas Municipal Code as Title I Chapter 310 and is available at the City's website [www.ci.milpitas.ca.gov](http://www.ci.milpitas.ca.gov) by selecting the Milpitas Municipal Code link.*

**Receive Report from the Citizens Task Force on Water Rates and a Staff Report on the Expenditure and Revenue Projections for the Water Fund (Staff Contacts: Tony Ndah, 408-586-2602 and Will Fuentes, 408-586-3111)**

**From the Task Force:** The Chair of the Citizens Task Force on Water Rates will provide a presentation to the City Council on its findings and recommendations. The written report and recommendations from the Task Force follows this agenda report.

**From City Staff:** The City of Milpitas owns and operates a safe drinking water distribution system in accordance with state regulations, and sets water rates to pass on wholesale water purchase prices and to ensure sufficient revenues are available to operate the water distribution system. Factors affecting the water rates include:

- increased cost of services for wholesale water supplies
- costs for City and wholesaler capital improvement programs, and
- costs for operation and maintenance of the water distribution system.

The purpose of this staff briefing is to provide a five-year expenditures and revenue projection for the Water Fund. Then, Council may provide direction to staff, as appropriate.

**Fiscal Impact:** None

**Recommendations:**

1. Receive a report from the Chair of the Citizens Task Force on Water Rates
2. Receive staff briefing on the expenditure and revenue projections for the Water Fund
3. Provide direction to staff

# **City of Milpitas**

## **CITIZENS TASKFORCE ON WATER RATES**

**October 18<sup>th</sup>, 2017**

## **Contents**

Section 1:	Introduction
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### **\*SECTION 1: Introduction**

On September 2016, the Milpitas City Council approved the creation of the Citizens Task Force on Water Rates (CTFWR). Each Council Member recommended two members for the Task Force while the Mayor made three. In March 2017 two new members were added by the newly elected Councilmembers making the total of the Task Force to thirteen. Subsequently, in May 2017, the Task Force's membership was reduced to twelve when the City Council approved the removal of one of the members due to lack of attendance. This was after a recommendation from the Task Force. Finally, on September 2017 one member of the Task Force resigned due to lack of attendance leaving the final membership to eleven.

## **Members**

Evelyn Chua (Chair)

Joseph Weinstein (Vice-Chair)

Steve Munzel (Parliamentarian)

Liz Ainsworth

Elpidio Estioko

Ted Grish

Rajeev Madnawat

Ray Maglalang

Dan Manassau

Robert Marini

Tom Valore

## **Objectives**

- 1. Gain** knowledge and understanding of our Water Infrastructure, Costs, Health & Safety, Regulatory Requirements, Maintenance and Capital Improvements

2. **Explore** feasibility of Alternative Rate Structures
3. **Identify** possible revenue enhancements in-lieu of current rates
4. **Recommend** infrastructure priorities and **Recognize** risks associated by not investing in Capital Improvement Projects (CIP)
5. **Brainstorm** effective ways of communicating and educating the Public

## **SECTION 2: Background**

The first Task Force meeting was in November 17, 2016 followed by the second meeting in February, 2017. In August 2017, the Task Force started preparing its report to the City Council and the residents.

Following a work plan, a field trip was scheduled to show the City's water distribution system. Moreover, the Task Force heard presentations from: City Attorney on legal; staff on water system supply, Health and Safety. The Chief Finance Officers (CFO) from San Francisco Public Utilities Commission (SFPUC), and Santa Clara Valley Water District (SCVWD), shared their overview of Capital Improvement Projects (CIP) including projected rate increases in the next five years. Staff presented the same City information as well.

SFPUC and SCVWD are wholesalers for water while South Bay Water Recycling (SBWR) is a wholesaler for recycled water. Additionally, a consultant from Bartle Wells and Associates (BWA) spoke about the rationale behind their recommendation of adopting a Uniform Water Structure for Milpitas.

Here are some terms:

"Water" means any system of public improvements intended to provide for the production, storage, supply, treatment, or distribution of water from any source. It includes Recycled Water.

"HCF" is an acronym for "hundred cubic feet". It is used for water metering and billing purposes. One HCF is equivalent to 748 gallons of water.

Capital Improvement Projects (CIP): A rolling 5-year plan for construction, major maintenance and improvements for water related projects. These are projects that meet one or more of these requirements:

- Mandated by law
- Multi-year project
- Community and master planning priority
- Major City Council initiatives
- Necessary to ensure Public Health and/or Safety
- Decrease City's risk to community
- Capital Outlay greater than \$5,000.00.

### **SECTION 3: Executive Summary**

It's necessary to point out that the Task Force Members are not experts in the field of "water", although, many members are experts in other areas. It takes years of education, certification and experience to be considered an expert. Members skimmed through tons on information from numerous expert presentations. The challenge was to filter only essential information to make relevant recommendations. That being said most of the data presented on this report is from the City of Milpitas Water Rates Study of December 8<sup>th</sup>, 2015 by Bartle Wells Associates (BWA). Consequently, the information might not be current but the same data was used by the consultant in the study. BWA's recommendations on water rates were subsequently implemented by the City beginning in January, 2016.

Moreover, it's clear from the knowledge gained during the course of the Task Force that its recommendations will be constrained because of several identified factors.

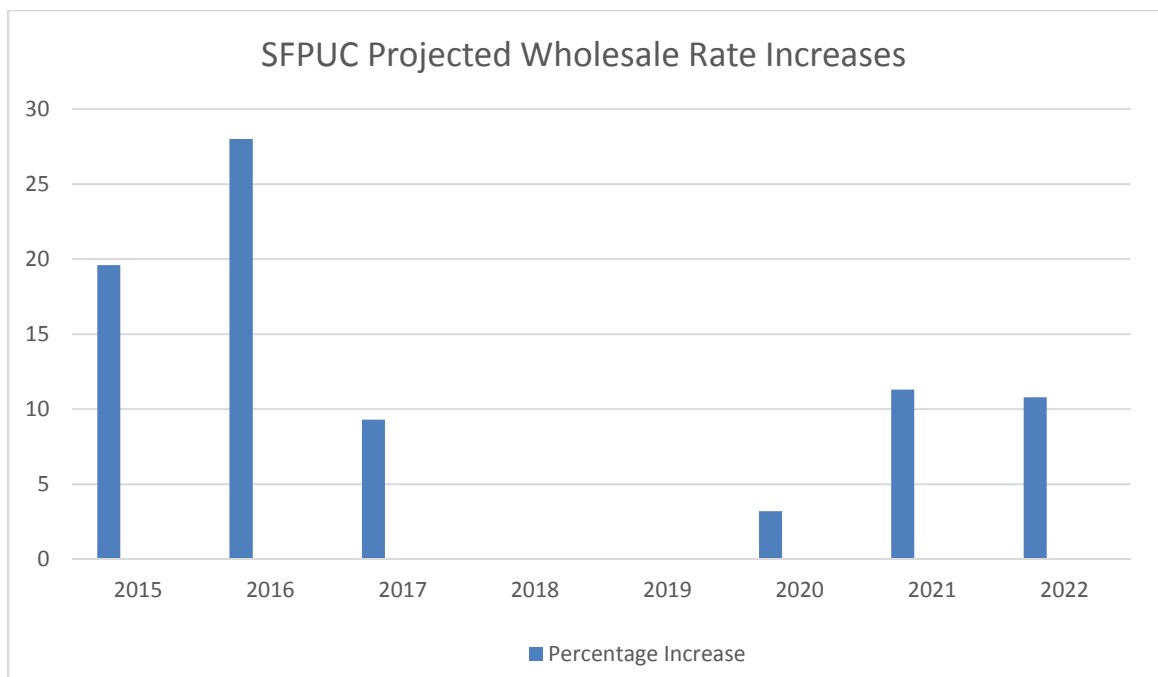
These factors have some bearings on the scope of the Task Force's recommendations:

1. SFPUC supplies more than half of the City's potable water supply. The remaining potable water is supplied by SCVWD. The wholesale revenue requirements include: operating costs, debt service, CIPs and more. Both agencies have planned on raising their rates in the next years.

For SFPUC, adopted and projected rate increases from 2015 through 2022 are as follows:

19.6% (2015),  
 28.0% (2016),  
 9.3% (2017),  
 no increases for 2018 and 2019,  
 3.2% (2020),  
 11.3% (2021) and  
 10.8% (2022).

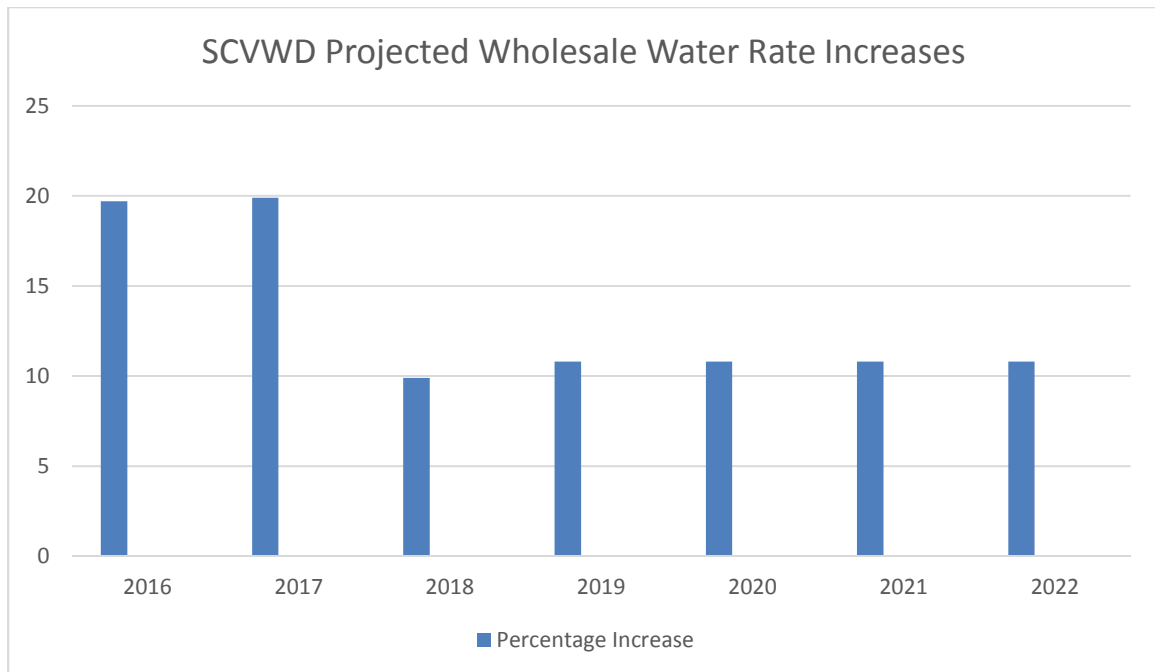
The data is derived from SFPUC Chief Financial Officer's (CFO) presentation to the Task Force on March 28, 2017.



For SCVWD, adopted and projected increases from 2016 through 2022 are:

19.7% (2016),  
19.9% (2017),  
9.9% (2018),  
10.8% (2019),  
10.8% (2020),  
10.8% (2021) and  
10.8% (2022).

Rate increases are taken from SCVWD CFO's presentation to the Task Force on February 28, 2017.



2. The City of Milpitas has very little say in the increases that SFPUC and SCVWD imposed on wholesale water costs, due to current contracts with both agencies.

For SFPUC, the City of Milpitas' agreement is dated July 2009 for a term of 25 years through June 2034. It is difficult to amend this agreement. Milpitas is required to purchase 5.341 MGD. It's called "take or pay" provision. During times of drought this provision can be waived.

For SCVWD, the City of Milpitas' agreement is dated September 1984 for a term of seventy (70) years through August 2054. Milpitas submits water quantities to be delivered every three years for a three-year schedule. Water quantities are estimated based on master plan, development, growth and others.

3. Capital Improvement Projects (CIP) were identified and approved by Council for the next five years. Even with a \$25.5M bond, these CIPs together with operational costs will be greater than the anticipated revenue for the same period.

Hence, BWA with their study has recommended and have implemented the following increases for both potable and recycled water consumption and meter charges:

- 8% in FY 2016/17,
- 8% in FY 2017/18 and
- 5% in FY 2018/19.

For Portable Capital Surcharge:  
\$1.30/HCF in FY 2016/17,

\$1.30/HCF in FY 2017/18 and  
\$1.74/HCF in FY 2018/19, a 33.8% increase.

Recycled Capital Surcharge is constant at \$0.17 from FY 2016 through FY 2019 (Bartle Wells Associate's City of Milpitas Water Rate Study of December 8, 2015, Appendix C, page 34).

The above numbers indicate that the costs are going to increase.

4. The City has experienced substantial reduction in water consumption for the last two years because of earlier state and city mandated water conservation. Moreover, with the SFPUC "take or pay" provision, the City still has to pay the minimum water consumption even if we don't use the water. An added expense since there is no revenue.

With the above factors affecting the City's water rates: SFPUC and SCVWD with projected increases in wholesale water rates; projected costs associated with operation and maintenance and Capital Improvement Projects (CIP) for the next five years; reduced water consumption and expenses being greater than revenue, the Task Force anticipates increases in water rates in the coming years as recommended by BWA in its study.

<b>Components of Water Bill Charges</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
1. Unit Charge	4.75	5.13	5.54	5.98	6.28
2. Meter Charge (residential 5/8 meter)	18.00	19.44	20.99	22.70	23.83
3. Capital Surcharge	1.30	1.30	1.30	1.74	1.74
Total bi-monthly charge of a household using 17 HCF of water in two months	<b>\$120.85</b>	<b>\$128.75</b>	<b>\$137.27</b>	<b>\$153.94</b>	<b>\$160.17</b>

### **SECTION 3: Recommendations**

It's good to point out that Task Force recommendations are directed toward policies. The recommendations include policies:

- To look at tiered rate water structure in detail that is good for the city
- To implement a comprehensive labor recording system to enhance financial reporting, labor accountability, and internal controls
- To remove the restriction allowing residents to increase their HCF usage and in doing so, reduce the cost requirement and safe guard the city's water allocation
- To investigate the possibility of providing assistance to persons living at or below the poverty level with paying their water bills
- To utilize internal and external communications using various traditional and non-traditional methods to inform residents of future water rate changes in an attempt to make sure that the public is well-informed.

## **Recommendation #1: Two-Tiered Water Rate Structure**

1. Recommend to have two-tiered water rates without violating Proposition 218 based on water usage/volume
2. Recommend to look at Robert Marini's spreadsheet as a suggested resource for determining a two-tiered water rate (The data has been taken from BWA's Water Study. However, it's prudent to point out that the accuracy of the assumptions and results need to be further investigated by water experts for validity)
3. Recommend to City Council to direct staff to find a consultant to present a two-tiered water rate that is suitable to our city.

## **Background**

In December 8<sup>th</sup>, 2015, Bartle Wells and Associates presented to the City Council the recommendation on water rate structure. This includes the recommendation to change the Milpitas water rates structure from tiered to uniform volume rate for water use. According to BWA their recommendation is to comply with constitutional mandate of Article 13D (Proposition 218) as well as various provisions of the California Water Code and Government Code that support and add further guidance for implanting these constitutional requirements.

However, BWA's study didn't go into the feasibility of a tiered rate structure for the City, it only explored a uniform structure. Similarly, BWA reiterated that the uniform structure complies with Article 13D, Section 6 (Proposition 218).

Subsequently, in early 2016, a tiered rate initiative that was signed by almost three-thousand Milpitas registered voters was presented to the City Council. The initiative was to present to the voters a tiered rate structure for approval. Even though, the initiative had the required number of valid voter signatures, it was rejected by the then City Council by 2-3 votes.

### **Laws Affecting Water Rates:**

What is Proposition 218?

#### **PROPOSITION 218** **Article XIII D, 6 (b)**

1. Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.

2. Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee was imposed.
3. The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.
4. No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to the owner of the property in question.
5. No fee or charge may be imposed for general governmental services such as police or fire services, where the service is available to the public at large in substantially the same manner as it is to property owners. (Note: Items #1 through #5 are from BWA's Water Rate Study of 12/8/15 page 6).

#### Proposition 218 (1996)

Allowed voters to repeal or reduce existing taxes, assessments, fees, and charges by initiative process:

- Reiterated voter approval requirements for general taxes (majority) and special taxes (2/3)
- Expanded restrictions on government spending Section 6 (a) established procedural requirements for imposing new, or increasing existing property-related fees and charges:
  - Must hold a public hearing and mail notice of the public hearing not less than 45 days prior to the public hearing
  - Rates may not be imposed if there is a majority protest

Proposition 218 requires that all taxes and fees imposed by a public agency must not be any greater than the "cost of service" to the individual. Litigants in the San Juan Capistrano Case (2015) argued that higher tiers do not involve higher costs per unit, and therefore violated Proposition 218. The court agreed. The city failed to demonstrate that the tiers correspond to the actual cost of providing service at a given level of use (The West/Insights, "San Juan Capistrano – Prop 218", October 10, 2013 page 2).

The court acknowledged *multiple times* in its opinion that tiered rates are consonant (in harmony) with and "not incompatible" with Article XIII, Section 6 (b), provided the rates reasonably reflect the cost of service attributable to each parcel (Kelly J. Salt, Journal AWWA-108.1 page 38).

Defendants unsuccessfully argued that tiered rates are a proven means of reducing waste of water, which is a separate Constitutionally mandated goal of California. While the court acknowledged the importance of conservation, it reasoned that agencies must achieve that goal without violating Proposition 218's requirement for proportionality (The West/Insights, "San Juan Capistrano – Prop 218", October 10, 2013 page 2).

City governments must be very careful in assessing any fees. The proof as to the accuracy of any fee or assessment must be provided by the city government (Kelly J. Salt, Journal AWWA-108.1 page 38).

One of the problems with San Juan Capistrano's tiered rate structure was that it exhibited "fractional precision" which the court believes suggested that the city did not attempt to correlate its rates with its costs of service (Kelly J. Salt, Journal AWWA-108.1 page 38).

In particular the court noted that "the difference between tier 1 and tier 2 was a tidy 1/3 extra. And the difference between tier 2 and 3 was a similarly exact 1/2 extra while the difference between tier 3 and tier 4 was precisely 5/6ths (Kelly J. Salt, Journal AWWA-108.1 page 38).

## Rationale

We are proposing two-tiered rates to be implemented with our Milpitas water rate structure. We understand that the cost of water includes all of the required costs of providing service, short term and long term, including the costs of operating, maintaining, financing, producing, storing, supplying, treating or distributing water from any source. And, that our proposed rate structure of the two tiers will be in compliance with California's Proposition 218.

Here are specific benefits:

- Residents who use less water are rewarded for saving water from the current fixed rate
  - Tiered rates encourage the use of water up to a limit of 10 HCF and reduces the cost to all residents even above the first tier, because everyone will save more money at the first tiered level than the current one rate
  - Residents using less water should not be penalized for people who over used water resources
  - The tiered rate recommended is revenue neutral.
- **A Tiered Rate Water Structure as a Resource:**
  - The table below is recommended as a resource for a tiered rate structure. The data should be updated if necessary.
  - **Considerations:**
    - **Bond Consideration**
      - The 30-year \$25MM bond with a 4.25% interest is used for water CIP
      - \$10MM of the bond will be used for recycled water
        - The recycled debt service is \$595,982 principal and interest per year (BWA Report page 22)
    - **Recycled Water Consideration**
      - **Current:**
        - Today, the annual cost of recycled water for principal and interest is \$595,982 and is distributed to the total water consumed per year of 3,427,828 HCF, is \$0.17/HCF used (BWA Study of 12/8/15 page 22; table 10).
      - **Proposed:**

- If the annual payment of \$595,982 is ONLY charge to the recycled water users, the increase is \$1.43 HCF.
  - Historically, recycled water cost in 2015 was \$4.08 HCF. The new recycled water fee of \$4.90 HCF is \$0.72 more than the 2015 fee.
  - This increases revenue to the water fund by \$595,982. Also, reduces the total water cost to all residents by \$0.17.
- **Recycled Water Consideration:** Based on City recycled water usage
  - The city reduced the cost of recycled water from **\$4.08 to \$2.78**, a difference of **\$1.30/HCF** for recycled water users
    - Consequently, the city itself is saving \$41,437 per year (\$1.30 \* 31,875 HCF/year). Hence, the revenue to the water fund is reduced by the same amount.
    - The rest of the recycled water consumed amounts to 408,224 HCF/year. The industrial usage is 4,331 HCF/year while recycled water is 403,793 HCF/year for irrigation water other than the city irrigation. The total amount is \$530,691/year which is loss of revenue to the water fund.
    - In the next few years, 80,000 HCF of potable water that the city consumes will be converted to recycled water. The cost of potable water today is \$6.43 HCF which will be reduced to \$2.78 because of the conversion. Hence, the difference in cost is \$292,000. This means the city saves \$292K in expenses while water fund lost the same amount.

<b>bond</b>	<b>recycled HCF</b>	<b>cost/HCF</b>	<b>total water HCF</b>		
\$595,982	416,218	<b>\$1.43</b>	3,427,828	\$0.17	
water cost 2017/18	\$2.88	total water	\$0.174	3,427,828	\$595,982
additional cost	<b>\$1.43</b>	recycled	<b>\$1.43</b>	416,218	\$595,982
base cost	<u>\$0.58</u>				\$0
Total: base +irrag	\$4.90	\$3.47			
<b>Plan A: Adjusted plan revenues compared to city's revenue</b>					
<b>HCF</b>	<b>new planned fees/HCF</b>	<b>quantity</b>	<b>new revenue</b>	<b>city planned fees/HCF</b>	<b>city revenue plan</b>
0- 10	\$6.17	1,081,000	\$6,669,770	\$6.43	\$6,950,830
11-20	\$6.26	400,000	\$2,504,000	\$6.43	\$2,572,000
>20	\$6.26	<u>110,000</u>	<u>\$688,600</u>	\$6.43	<u>\$707,300</u>
sub total		1,591,000	\$9,862,370		\$10,230,130

Commercial industrial, institutional, construction	\$6.26	1,010,649	6,326,663	\$6.43	\$6,498,473
potable irrigation	\$6.26	365,000	2,284,900	\$6.43	\$2,346,950
Ed Levin Park	\$4.55	2,610	11,876	\$4.05	\$10,571
recycled irrigation	\$4.90	403,793	1,978,586	\$3.47	\$1,400,395
recycled institutional dual-plumbed, construction	\$4.90	4,331	21,222	\$3.47	\$15,020
recycled city of Milpitas	\$4.90	31,875	156,188	\$3.47	\$110,546
sub total		1,818,258	10,779,433		\$10,381,955
			<b>new revenue</b>		<b>city revenue</b>
		total	<b>\$20,641,803</b>		<b>\$20,612,085</b>
difference in revenue			\$29,719	\$0.03	

## **Recommendation #2: Cost Allocation Plan (CAP)**

- 1) Task the Finance Director of the City to review the Cost Allocation Plan and select the most appropriate basis.
- 2) Amend Page 5 of the "City Cost Allocation Plan" to include the rationale for the allocation basis used to allocate the indirect costs.
- 3) Direct Staff to evaluate in detail the relative cost and benefits of implementing a comprehensive labor recording system to enhance financial reporting, labor accountability, and internal controls.

### **Background**

The City Cost Allocation Plan is missing important documentation. The rationale for the allocation basis which explains why the allocation basis was selected and why it is the most relevant one to use is not included in the plan. The city has no timecard or other records of daily hours worked by task so audit by task is not possible.

### **Rationale**

A Cost Allocation Plan impacts the cost of water and needs to be addressed. The cost of these services is currently included in the basis (total operating Budget) used to allocate some indirect department costs to the utility and other funds. These services have not been relevant to the finance and other costs being allocated. For example, the Finance Department costs being allocated are mostly labor related and do not increase or decrease in relation to the cost of

water, sewer, or solid waste. That is why those costs need to be backed out of the allocation base.

### **Recommendation #3: Water Conservation**

Earlier in 2017 the Milpitas City Council voted to require a 10% reduction in water use by Milpitas Citizens and water consumers. The Task Force recommends that the City Council remove recommended restrictions in use.

### **Background**

Milpitas has a “take or pay provision” in the contract with San Francisco Public Utilities Commission (SFPUC). It provides more than half of Milpitas’ water. Moreover, the City is taking in less money than the cost to supply water for the residents and the city needs.

### **Rationale**

There are two objectives for the recommendation:

1. To keep the water cost down to a minimum for residents and water consumers
2. To maintain an appropriate allocation of water to the City of Milpitas.

Milpitas is contracted to pay for 2.6 million HCF annually regardless of whether we use that volume or not. Residents are currently charged \$5.13/HCF.

At this price, the cost for 2.6 million HCF is \$13,338,000.00.

- At 10% reduction in use will result in the delivery of 2,340,000.00 HCF, while Milpitas must still pay for 2.6M HCF. In order to pay the full contracted amount, the price per HCF will have to increase to \$5.70/HCF. An increase of 57 cents per HCF.
- The calculation is based on numbers that are 3 or 4 years old. In the financial years 2014-15 and 2015-16. Milpitas has been using less than the allocated 2.6M HCF a year.

The rationale is that by restricting water use by 10% will result in a necessary increase in cost per HCF to the consumer, the Milpitas residents.

In addition, the City is in deficit in water cost and revenue coming in. It’s taking less money than the cost to supply for the residents and the city needs. By removing the restrictions, there is an opportunity to use more water. Therefore, billing for more water and an opportunity to reduce the deficit.

Objective 2 arises because there is a concern that by continually using less than the “take or pay” allocation, in future years when water may be limited there is a risk that the allocation to Milpitas will be reduced. As the Milpitas population is increasing with new development, this is a major concern.

In conclusion, the Task Force asks that the City Council remove the restriction allowing residents to increase their HCF usage and in doing so, reduce the cost requirement. It is also hoped that this will help to narrow the deficit and anticipated a safe guard in our allocation of water.

#### **Recommendation #4: Assistance on Water Bill for Low Income Residents**

For the City to investigate implementing a system that will allow low income residents to be able to get assistance with paying their water bills.

##### **Background**

The City of Milpitas has for many years acted to assist citizens in need. We provide subsidized nourishing meals for Seniors, subsidized Senior housing and Senior discount at the Milpitas Sports Center. We subsidize a food distribution location for low income persons.

##### **Rationale**

The Task Force suggests that the City investigate the possibility of providing assistance to persons living at or below the poverty level with paying their water bills. There may be grants or new legislation that could help to fund such a program.

#### **Recommendation #5: Communicating to Residents of Water Rate Changes**

Recommend to the City Council to consider the proposed communication strategy in informing the residents on water rates.

##### **Background:**

One of the reasons why the Citizens Task Force on Water Rates was formed was because of the lack of communication in informing the residents on the new water rates. Hence, the Task Force was formed with one of the goals of coming up with an effective communication strategy to inform and educate the public on water usage and rates.

##### **Rationale:**

We are recommending this communication strategy for the City Council to have a complete resource in reaching out to the public, either by adopting this proposal or incorporating it

with existing communication strategy the city has in place. By coming out with a comprehensive communication plan in reaching out to both internal and external publics using all means of communication, it will enhance knowledge, awareness, and acceptance by the residents of the action to implement a new water rate.

The City's website and newsletter on city projects have been effective in the past but somehow were not able to reach out the majority of the public. Therefore, there must be an additional plan or means to cover a wider number of people by adding other communication means such as public forums or town hall meetings separate for both staff and the public, which will complement or supplement the existing communication tools. Other tools such as a comprehensive issuance of press releases for traditional and new media, distribution of fact sheets in the form of Q & A, and the rest of the proposed communication tools will cover a wider spectrum of the city residents. The fact sheet should be published in multiple languages.

By utilizing internal and external communications using various traditional and non-traditional means of communication in informing the public as proposed will promote wider acceptance of the new water rates.

## **SECTION 5: Closing Statement**

In comparing goals with deliverables, here is the summary:

1. **Gain** knowledge and understanding of our Water Infrastructure, Costs, Health & Safety, Regulatory Requirements, Maintenance and Capital Improvements:

*It takes many years of experience, training and education to be an expert on "water". Members are not experts but are experts in other areas. On the other hand, members have gained considerable knowledge to make recommendations.*

2. **Explore** feasibility of Alternative Rate Structures:

*Recommendation 1 asks the Council to investigate the Tiered Water Rate Structure. The Task Force is asking the City Council to direct staff to find a consultant to present a two-tiered water rate structure that is suitable to our City. This will be a prudent investment for the City Council to have a better understanding of the tiered rate structure as compared to the uniform water rate structure.*

3. **Identify** possible revenue enhancements In-Lieu of current rates:

*The Task Force looked at other sources of revenue other than increasing the current rates. Unfortunately, except for the usual sources of revenue such as grants, Transit Area Specific Plan (TASP) fees, developers' fees and Interest income, no other revenue stream was recommended.*

**4. Recommend** infrastructure priorities and **Recognize** risks associated by not investing in Capital Improvement Projects (CIP):

*The Task Force evaluated delaying or eliminating some of the projects to reduce the bond or totally eliminate the projects so as not to have a \$25.5M bond. The conclusion is that these projects are mandated by law, necessary for long term reliability, and/or necessary for the delivery of safe water. Additionally, delaying the projects will likely cost more in the future.*

**5. Brainstorm** effective ways of communicating and educating the Public:

*A communication strategy has been introduced to the Council for consideration to ensure changes to water rates are communicated effectively to all residents.*

**In conclusion**, the Task Force also recommends to the City Council to evaluate the Cost Allocation Plan (CAP) for transparency and accountability, presents the benefits of not having restrictions on water conservation to reduce expense and find ways of assisting low-income residents with their water bill.

END



# Water Utility Expenditure and Revenue Projections

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**Tony Ndah**  
Acting Public Works Director

**Will Fuentes**  
Director of Financial Services

October 2017

## 1. Introduction:

The City's policy and State law require that the water utility is managed in a manner similar to a private enterprise. The water finances are kept in separate funds and are not subsidized by other revenue sources, nor do they generate profit. Ideally, water rates are set to an amount covers the cost for wholesale water, as well as supports the total short term and long term direct and indirect cost of the utility operations, including depreciation of infrastructure assets, overhead charges, reserves, and current and future capital improvements. The water utility fund maintains operating reserves to serve as a contingency fund if revenues should be lower and/or expenses should be higher than expected. The City's reserve policy for the water fund is 30% of the water fund annual operating budget.

Water rate increases from wholesale suppliers continues to drive up cost to the City; however, the City's current water rate, which has been in effect since April 2016, has not been changed to keep up with these increased costs. Consequently, an analysis of the estimated water fund expenses and revenues show that the water utility would have insufficient funds starting in fiscal year 2018/2019 to maintain the required 30% reserve target for the City.

## 2. Current Water Meter Charges and Water Rates:

On December 15, 2015, the City adopted new water meter charges and water rates for the water utility. The rates were implemented to two phases, with the first increase becoming effective in January 2016 and the next rate increase becoming effective in April 2016. The current water meter charges and water rates for the City are shown in the tables below:

Table 1: Council Adopted Water Meter Charges (FY 2016/17)

FIXED METER BI-MONTHLY CHARGES		FIRE METER BI-MONTHLY CHARGES	
Meter Size	Charge	Fire Service Line Size	Charge
5/8 inch	\$19.44	2 inch	\$31.10
3/4 inch	\$29.16	3 inch	\$58.32
1 inch	\$48.60	4 inch	\$97.20
1-1/2 inch	\$97.20	6 inch	\$194.40
2 inch	\$155.52		
3 inch	\$291.60		
4 inch	\$486.00		
6 inch and above	\$972.00		

Table 2: Council Adopted Water Rates (FY 2016/17)

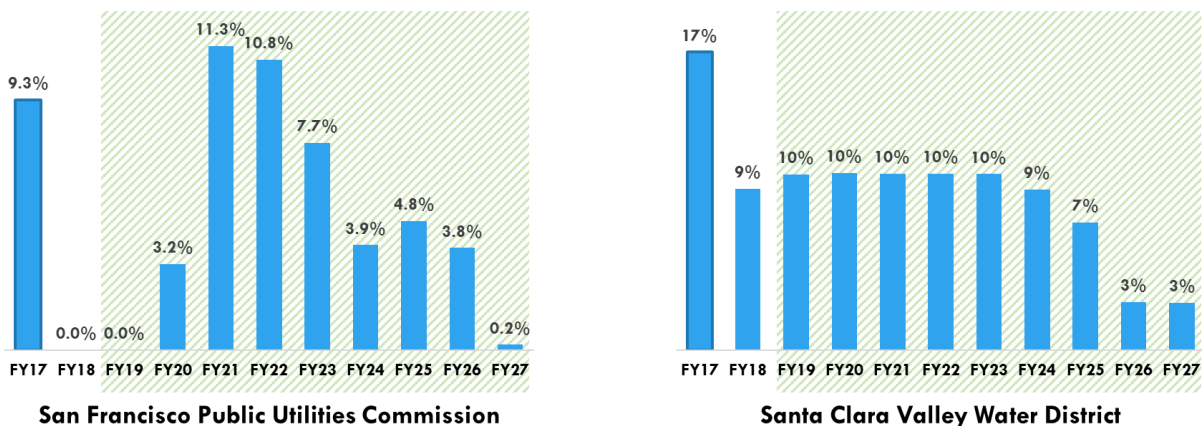
Quantity Charges (Charge per Hundred Cubic Feet)		
Category	Volumetric Charge	Capital Surcharge
<b>Residential:</b>		
0 – 10 HCF	\$5.13	\$1.30
11 – 20 HCF	\$5.13	\$1.30
21 – 30 HCF	\$5.13	\$1.30
> 30 HCF	\$5.13	\$1.30
Commercial, Industrial, Institutional, Construction	\$5.13	\$1.30
Potable Irrigation	\$5.13	\$1.30
Ed Levin Park**	\$4.10	NA
City of Milpitas	\$5.13	\$1.30
Recycled Irrigation	\$2.78	NA
Recycled Industrial, Dual-plumbed, Construction	\$2.78	NA
Recycled City of Milpitas	\$2.78	NA

Per the water rate study completed in December 2015, it was recommended that the City should increase the unit volumetric unit rate for water by 8% by July 2016, 8% by July 2017, and 5% by July 2018. Currently the 2016/17 fiscal year water rate charge of \$5.13 per HCF is still in effect.

### 3. Water Costs:

The majority of the City's cost to provide water is the wholesale purchase cost of the water. The City holds long-term supply contracts for wholesale potable water from the San Francisco Public Utilities Commission (SFPUC) and the Santa Clara Valley Water District (SCVWD). These contracts allow these suppliers to set wholesale prices to recover their cost of service. The wholesale water cost are projected to increase in the coming years as shown on the charts below:

**Chart 1: Ten Year Wholesale Water Rate Future Projections**



#### 4. Operating Costs:

The City owns a complex pipeline distribution network of over 200 miles of pipe, operated as seven distinct seven pressure zones through the use of pump stations and pressure regulating valves to ensure that all areas of the City have a constant supply of pressurized water for fire fighting , public health, and sanitation.

#### 5. Five Year Revenue and Expenditure Analysis

The five-year revenue and expenditure analysis is performed by starting with the actual July 2017 water fund balance and estimating revenues and expenses to project an expected fund balance for the years ahead. The five-year revenue and expenditure analysis takes a conservative approach and assumes the following:

- wholesale water purchases for the City remain constant, with the wholesale water rate increasing each year, based on projected water rate increase from the wholesale water providers.
- City's current volumetric water rate charge of \$5.13 per HCF remains in effect during the course of the 5-year projection.
- The analysis assumes the operating costs for the City would increase by 3% each year, with no new personnel added to the water utility.

The five year estimated revenues and expenditures the water utility is shown in the table below. The analysis of the estimated water fund expenses and revenues show that the water utility would have insufficient funds starting in fiscal year 2018/2019 to maintain the required 30% reserve target for the City. These projections were also presented to the Water Rates Task Force. An adequate reserve is necessary to account for unforeseen emergencies, issue debt when needed, and preserve the City's excellent credit rating.

Table 3. Five Year Projected Water Utility Revenue and Expenditures

	<i>Proposed Fiscal Year 17/18</i>	<i>Proposed Fiscal Year 18/19</i>	<i>Proposed Fiscal Year 19/20</i>	<i>Proposed Fiscal Year 20/21</i>	<i>Proposed Fiscal Year 21/22</i>
Wholesale Costs of Water	\$15.9 million	\$16.5 million	\$17.4 million	\$19.2 million	\$21.6 million
Total City Operations Costs	\$10.5 million	\$9.3 million	\$9.6 million	\$9.8 million	\$10.8 million
Total Costs:	\$26.5 million	\$25.7 million	\$27.0 million	\$29.2 million	\$32.5 million
Total Revenue	\$26.2 million	\$25.2 million	\$25.2 million	\$25.2 million	\$25.1 million
Short revenue	-\$190,000	-\$545,000	-\$1.76million	-\$3.97 million	-\$7.4 million

## 6. Next Steps

Staff recommended next steps are as follows:

- Water Rates Study – Complete a water rates study and recommend the rate structure needed to meet operating requirements, capital improvements, regulatory obligations, and reserve funding levels. The water rates study would evaluate the financial impact of various rate alternatives and provide the following:
  - i. Develop different rate options for consideration by the City
  - ii. Rates will be developed to support the City’s proposed issuance of water bonds
  - iii. The new rates would be effective July 1, 2018

The water rate developed as part of the water rates study would impact the issuance of a new water bond for the water utility. The Bond will be lower than \$25 million noted in the CIP due to using capital surcharge on “pay as you go” basis for projects in the last few years, but the City will not be able to issue a new bond to address major CIP projects without an appropriate rate that allows the City to meet its obligations. The bond market wants to both see that the City is able to cover its operating expenses and have an approved plan for future rate increases (i.e. an approved annual rate plan for 2 to 3 years).

- Public Outreach and Community Engagement – a critical step in this process includes the incorporation of input from the community throughout the development of the new rates and rate structure. Public outreach and community engagement would consist of the following:
  - i. Stakeholder outreach
    - a. Community outreach via water rate workshops
    - b. City Council presentations at Council meetings
  - ii. Develop Outreach materials
  - iii. Prop 218 process and hearing
- Cost Allocation Plan – The City has a Cost Allocation Plan (CAP) in place to identify indirect overhead costs needed to support operations in its Enterprise Funds, such as the water utility fund, and other areas. The current CAP methodology was developed internally and approved by the City Council in 2014. It is updated annually with current information. The Director of Financial Services has reviewed the CAP and believes it to be sound in its distribution of indirect overhead costs and its ability to adhere to federal granting requirements. The plan has also been reviewed by outside consultants and they too believe the CAP and its methodology to be sound. Nevertheless, it is good practice to periodically review the CAP and update its cost drivers and methodology where appropriate. Thus, the Director of Financial Services has contacted several consultants who are subject matter experts in the field to prepare a new CAP. The CAP consultant will thoroughly examine personnel time and other overhead costs required to serve various City functions including the water utility fund. Staff is also exploring the purchase of software that will allow the CAP to be continuously updated using data from the City’s Enterprise Resource Planning (ERP) software. Once

selections of a CAP consultant and software are made, staff will return to Council with a budget appropriation request. Estimated costs for consultant and software are \$50,000. Update of the CAP was an area of concern addressed by the Water Rates Task Force and the Director of Financial Services fully supports a refresh to ensure accuracy, transparency, clarity, and best practice. The results of the revised CAP may impact the indirect overhead costs assigned to the water utility fund; either positively or negatively.